

Strategy

Blistering rally to soon take pause

Key message

1. We predict a correction in the Taiex following the bull run to 20,000 points.
2. Consensus 2Q-3Q24F earnings muted on slow season (ex. AI); significant buying of high-dividend ETFs and the overweighting in stocks by funds globally both signal an overheated market.
3. Top picks – High-dividend, low valuation plays.

Correction inevitable as Taiex hits 20,000-point mark

We believe the AI frenzy will continue to support consensus Taiex earnings growth of 20% each year in 2024-25F, as well as a bullish Taiex over the long term. Near term, non-AI applications such as PC, handset, industrial and automobile are entering slow season and facing uncertain recovery, which is weighing on overall Taiex earnings in 2Q-3Q24F and therefore further market upside. In addition, the overweighting in stocks by funds globally is nearing the kind of overheated levels as seen in the past, which often presages a market correction. And lastly, significant buying of high-dividend ETFs points to a looming ‘shoeshine boy’ event, also an ill omen for the Taiex.

Ex. AI, 2Q-3Q24F consensus Taiex earnings muted on slow season

Judging by recent corporate financials and analyst meetings, we conclude that AI is the only sector that will perform well. The market has been pumped on AI PC and AI handset demand since the end of last year and is optimistic about a recovery of PC and handset demand in 2024F. However, we believe the current market euphoria needs to be tempered, based on feedback from end markets, namely: (1) consensus 2024F global PC shipments growth estimate will likely be revised down from 6% to low single digits; and (2) consensus 2024F handset shipments growth estimate will likely be cut from 4% to flattish. Moreover, due to a stalling China economy, industrial manufacturers globally are now guiding for lower-than-previously-projected sales for 1Q24F, while the EV market is slowing significantly. All told, we don’t think Taiwan’s robust AI server shipments are sufficient to fill the gap left by a fragile recovery in non-AI demand, and thus don’t expect Taiex earnings to impress in 2Q-3Q24F. We forecast Taiex earnings growth YoY in each quarter of 2024F will be 23%, 18%, 9% and 31%. A weakening earnings growth trend often depresses Taiex performance.

Global funds stock investment weighting nears overheated levels

According to a March survey, the investment weighting in stocks by funds globally now exceeds 28%, one standard deviation above the long-term average. This has historically portended a stock market correction in the medium term. If this ratio is two standard deviations higher, it points to a bearish turn for the market. Since the ratio exceeds the average by one standard deviation, market bullishness will be capped.

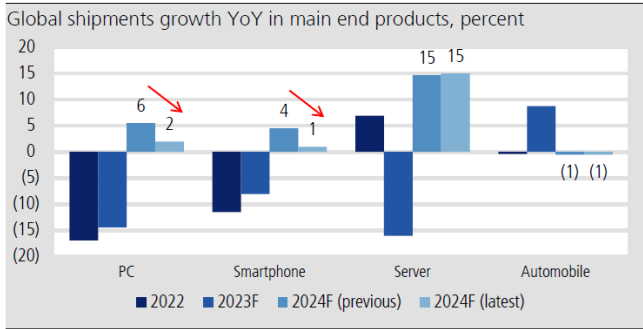
‘Shoeshine boy’ event looming in Taiwan

Taiwanese investors have been significantly buying into high-dividend ETFs recently, which suggests the ‘shoeshine boy’ theory of stock investment is playing out, with local investors once again ignoring the market axiom that an overcrowded market is a precarious market to be in. The record-breaking Taiex seen during the COVID-19 pandemic saw local investors pile into active stock funds in 2021, only to get burnt by the market slump in 2022. And in 2023, betting on US rate cuts, retail investors stampeded into bond ETFs, later incurring on-paper losses based on an average subscription cost of 3.9%, which was the average 10-year Treasury yield last year.

Valuation & Action

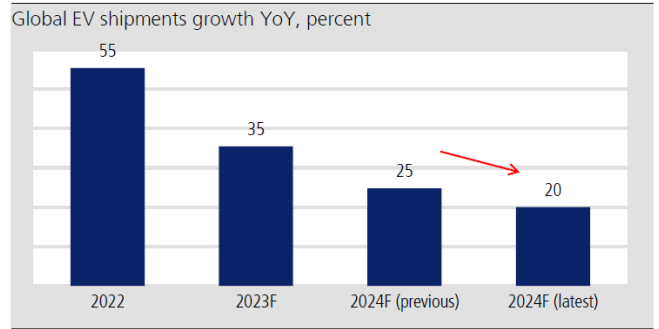
Although we believe Taiex bullishness is intact for the long term, we see a correction as inevitable. This is because AI is the only strong sector, with overall Taiex earnings to be hit by slow season in 2Q-3Q24F. Meanwhile, the overweighting in stocks by funds globally and overzealous buying by Taiwanese investors of high-dividend ETFs are both warning signs of an overheated stock market. We recommend investors shift to defensive trading. Our top picks are high-dividend, low-valuation plays.

Figure 1: 2024F PC & handset recovery disappointing



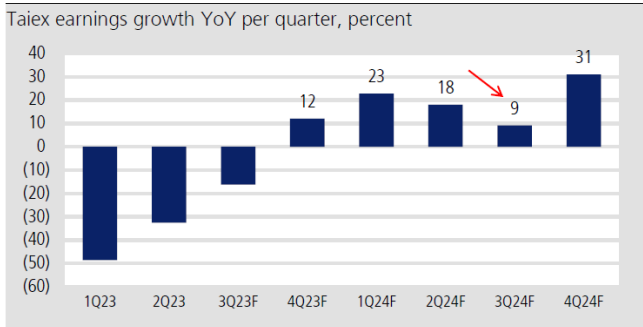
Source: KGI Research

Figure 2: Slower 2024F EV shipments growth



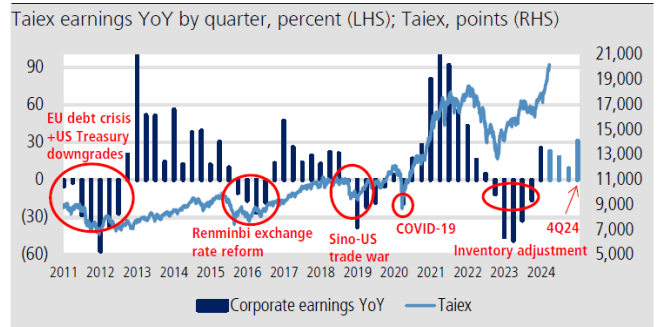
Source: KGI Research

Figure 3: 2Q-3Q24F Taiex earnings hit by slow season



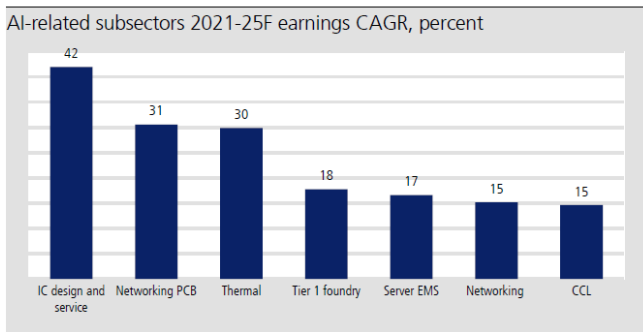
Source: TEJ; KGI Research

Figure 4: Weakening earnings weigh on Taiex



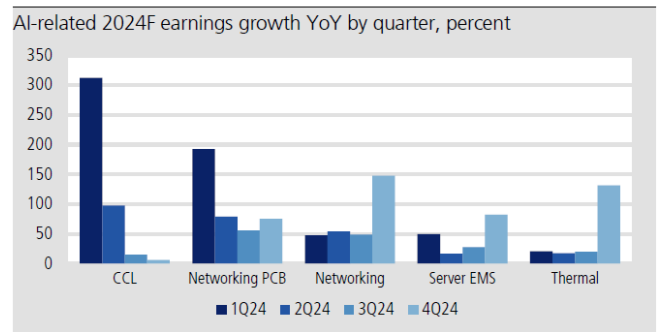
Source: TEJ; KGI Research

Figure 5: AI-related subsectors 2021-25F earnings CAGR of 20-40%



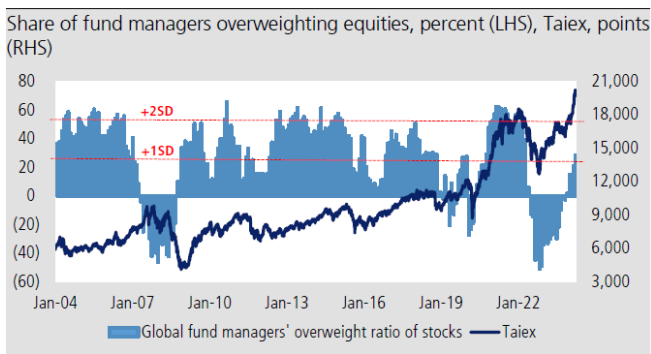
Source: TEJ; KGI Research

Figure 6: AI-related 2Q-3Q24F earnings hit by PC & handset



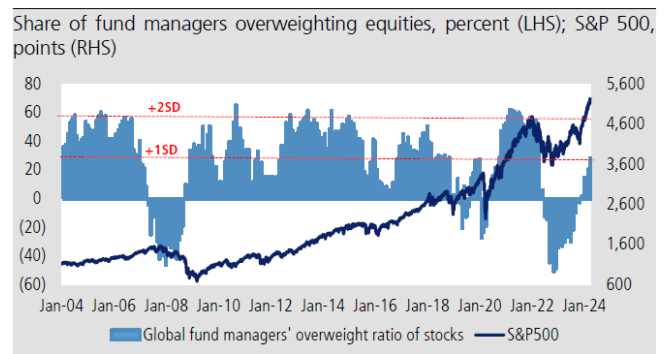
Source: TEJ; KGI Research

Figure 7: Global funds stock investment weighting nears overheated mark

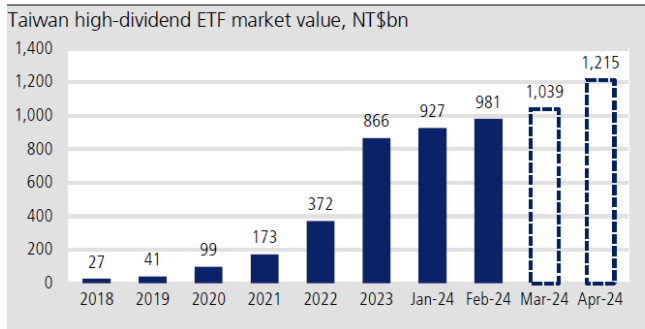


Source: BoA Global Fund Manager Survey; Bloomberg; KGI Research

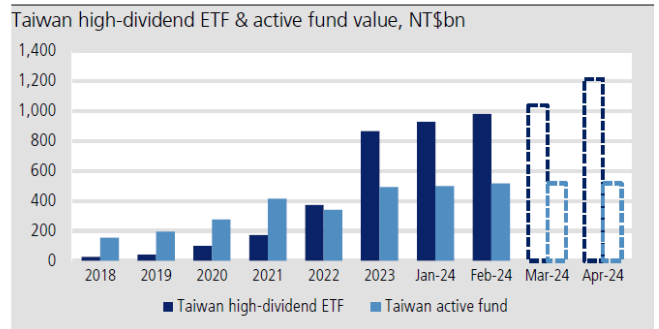
Figure 8: Global funds stock investment weighting nears overheated mark



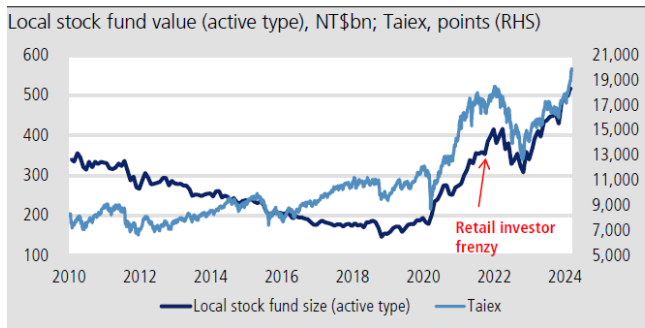
Source: BoA Global Fund Manager Survey; Bloomberg; KGI Research

Figure 9: Taiwan high-dividend ETFs surge


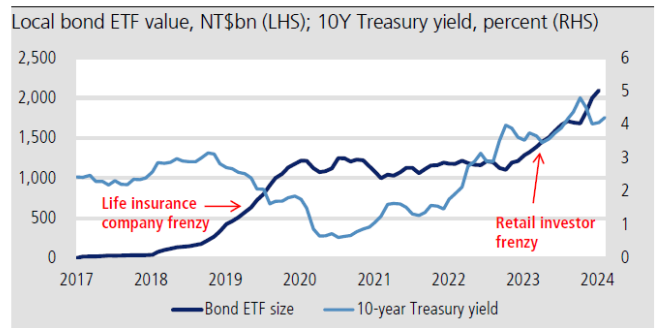
Source: TEJ; KGI Research

Figure 10: Taiwan high-dividend ETF value overtakes active fund value


Source: TEJ; KGI Research

Figure 11: Hot sales of stock funds validates 'shoeshine boy' theory


Source: TEJ; KGI Research

Figure 12: Strong bond ETF sales validates 'shoeshine boy' theory


Source: TEJ; KGI Research

Figure 13: Taixex now at 2024F PE of 19x

Forecasted Taixex matrix (points)	Target PE(X)						
	15	16	17	18	19	20	21
0	13,025	13,893	14,761	15,630	16,498	17,366	18,235
10	14,327	15,282	16,237	17,193	18,148	19,103	20,058
15	14,978	15,977	16,976	17,974	18,973	19,971	20,970
20	15,630	16,672	17,714	18,756	19,798	20,840	21,882
25	16,281	17,366	18,452	19,537	20,622	21,708	22,793
30	16,932	18,061	19,190	20,319	21,447	22,576	23,705
35	17,583	18,756	19,928	21,100	22,272	23,445	24,617

Source: TEJ; KGI Research

Figure 14: Taixex now at 2025F PE of 16x

Forecasted Taixex matrix (points)	Target PE(X)						
	15	16	17	18	19	20	21
0	15,580	16,619	17,658	18,696	19,735	20,774	21,812
10	17,138	18,281	19,423	20,566	21,708	22,851	23,994
15	17,917	19,112	20,306	21,501	22,695	23,890	25,084
20	18,696	19,943	21,189	22,436	23,682	24,928	26,175
25	19,475	20,774	22,072	23,370	24,669	25,967	27,265
30	20,254	21,605	22,955	24,305	25,655	27,006	28,356
35	21,033	22,436	23,838	25,240	26,642	28,044	29,447

Source: TEJ; KGI Research

Figure 15: Taixex - Valuations

	Forward PB(X)									Forward PE(X)							
	Forward 1-year	2024	2025	5-year average	10-year average	20-year average	2007 peak	2008 bottom	Forward 1-year	2024	2025	5-year average	10-year average	20-year average	2007 peak	2008 bottom	
Taixex	2.03	2.03	1.88	1.71	1.61	1.62	2.28	0.95	19.45	19.45	16.19	15.04	14.91	17.12	21.73	8.80	
Taixex excl. TSMC	1.57	1.57	1.45	1.40	1.38	1.46	2.22	0.89	19.03	19.03	15.61	14.73	14.90	16.02	22.71	8.06	

Source: KGI Research and KGI estimates

Figure 16: Taix sub-sectors - Valuations

		Earnings YoY (%)						Earnings revise direction		Forecast PE(x)		
		2022	KGI forecast (latest)		KGI forecast (3m before)		Consensus (latest)		2023F	2024F	2023F	2024F
			2023F	2024F	2023F	2024F	2023F	2024F				
Tech	Networking PCB	56.1	(22.7)	83.9	(17.6)	75.5	(18.7)	71.5	↓	↓	22.5	18.8
	CCL	(7.7)	8.2	52.6	10.8	36.7	9.7	56.6	↓	↑	26.8	17.6
	ABF	102.5	(68.1)	47.5	(69.7)	43.2	(69.6)	24.6	↑	↑	339.1	18.6
	IC design and service	94.8	5.3	45.3	6.8	55.6	7.6	35.9	↓	↓	63.1	44.6
	Server EMS	(9.3)	10.2	40.6	8.7	41.5	9.7	43.8	↑	↑	33.6	22.1
	Thermal	50.6	9.1	39.3	19.7	27.6	18.9	24.7	↓	↓	38.1	27.0
	Passive components	(0.8)	(24.7)	30.2	(24.7)	30.2	(22.7)	15.5	-	-	14.6	11.2
	Handset components	28.4	(36.5)	29.4	(35.5)	20.7	(35.1)	23.1	↓	↑	17.1	12.7
	Networking	77.3	15.2	24.2	(12.4)	(22.5)	18.9	22.9	↑	↑	23.6	18.6
	First-line foundry	70.4	(17.5)	18.0	(19.5)	21.2	(19.0)	20.5	↑	↓	24.3	20.6
	Handset EMS	(2.1)	0.8	17.3	(7.2)	12.1	(5.3)	17.9	↑	↑	15.7	14.2
	IC design (handset/consumer)	(2.9)	(32.6)	17.1	(35.7)	20.7	(35.5)	26.7	↑	↑	24.0	19.9
	Cloud digital	16.3	17.1	15.4	18.5	19.0	17.8	15.7	↓	↓	31.2	25.6
	Power supply	15.1	4.3	6.7	4.2	6.8	4.9	2.9	↑	↑	23.2	21.6
	Telecom	2.6	13.7	(2.4)	8.5	1.9	6.9	6.9	↑	↑	27.3	27.5
	Silicon wafer	29.5	25.1	(7.9)	25.1	(7.9)	25.2	(14.2)	-	-	13.4	14.6
	Second-tier foundries	51.6	(33.3)	(11.6)	(36.2)	1.9	(36.1)	(12.5)	↑	↓	15.2	18.2
	TFT	-	Loss reduced	Loss reduced	Loss reduced	Loss reduced	Loss reduced	Turned profitable	↓	↑	N.A.	N.A.
	Memory	(36.0)	Turned unprofitable	Turned profitable	Turned unprofitable	Turned profitable	Turned unprofitable	Turned profitable	↓	↓	N.A.	25.9
Non-tech	Steel	(75.4)	(89.0)	368.2	(62.9)	381.8	(90.3)	546.0	↓	↓	212.1	38.0
	Container shipping	19.7	(94.4)	82.0	(92.9)	(92.4)	(93.3)	(11.3)	↓	↑	7.1	N.A.
	Green energy	56.9	69.7	76.0	69.7	76.0	91.7	60.9	-	-	34.0	15.3
	Auto parts	52.8	(24.7)	53.2	(20.6)	46.6	(19.3)	37.9	↓	↓	20.9	13.6
	Petrochemicals	(63.1)	(50.6)	52.6	(43.0)	(28.9)	(39.5)	47.3	↑	↑	46.6	25.8
	Shoe-making	100.0	(44.2)	48.6	(44.2)	48.6	(42.4)	40.0	-	-	31.4	21.1
	Heavy electrical	(1.9)	42.9	48.0	41.3	43.3	42.5	44.9	↓	↑	49.5	32.1
	Food & beverage	(2.7)	94.1	23.4	108.3	20.9	103.4	13.3	↓	↓	18.6	14.9
	Industrial automation	5.2	(14.2)	21.5	(13.2)	28.7	(12.4)	21.4	↓	↓	37.1	29.3
	Aerospace	135.4	21.3	20.1	36.7	16.9	29.2	14.6	↓	↓	4.7	21.9
	Apparel	32.1	(11.3)	14.1	(10.4)	10.0	(10.7)	16.5	↓	↑	26.6	23.4
	Food	(13.6)	6.8	13.1	23.4	10.1	24.3	2.6	↓	↓	23.4	20.7
	Tourism	(46.5)	176.4	8.5	177.9	24.2	163.9	13.1	↓	↓	19.7	17.6
	Bicycle	(12.7)	(38.8)	(3.5)	(35.3)	17.4	(35.9)	9.2	↓	↓	27.2	27.8
	Cement	(50.7)	31.4	(9.3)	31.4	(9.3)	20.0	8.7	-	-	17.0	18.3
	Airlines	(37.8)	185.5	(38.3)	227.7	(22.3)	209.8	(36.1)	↓	↓	12.5	18.3
	All	Technology	17.8	(20.3)	23.5	(20.7)	22.2	(19.6)	23.4	↑	↑	
Non-tech		(12.0)	(69.8)	30.9	(68.5)	24.2	(67.5)	17.7	↓	↑		
Taix		(3.7)	(28.8)	22.1	(27.0)	19.6	(34.5)	22.5	↓	↑		

Source: KGI Research and KGI estimates

Figure 17: Our top picks

	Company	Code	Investment rating	Target price (NT\$)	Mkt cap (US\$mn)	Share price (NT\$)	Change +/- (%)	EPS (NT\$)		PE (x)		P/B (x)		ROE (%)		Cash yield (%)	
								2023F	2024F	2023F	2024F	2023F	2024F	2023F	2024F	2023F	2024F
High yield stocs	Novatek	3034 TT	Outperform	660.0	11,267	591.0	11.7	38.32	39.38	15.4	15.0	5.4	5.0	35.2	34.4	5.2	5.4
	MTK	2454 TT	Neutral	986.0	58,382	1165.0	(15.4)	48.51	57.98	24.0	20.1	4.5	4.4	17.9	21.9	4.7	5.4
	SMP	6121 TT	Neutral	600.0	2,645	456.5	31.4	30.67	33.37	14.9	13.7	2.4	2.3	16.7	17.3	4.8	5.2
	Catcher	2474 TT	Neutral	190.0	4,551	213.5	(11.0)	17.81	12.69	12.0	16.8	0.8	0.7	6.8	4.1	4.7	4.7
	CTCI	9933 TT	Outperform	53.0	1,203	47.6	11.3	2.39	3.54	19.9	13.4	2.1	2.1	10.7	15.4	4.3	6.6
	TWM	3045 TT	Neutral	103.0	11,898	102.0	1.0	4.35	3.80	23.4	26.8	5.9	6.0	19.0	18.0	4.2	4.2
	CTBC Holdin	2891 TT	Outperform	34.0	20,041	32.6	4.3	2.86	3.24	11.4	10.1	1.6	1.3	14.9	14.1	4.0	4.3
Low valuations with fundamentals troughing	Hon Hai	2317 TT	Outperform	164.0	64,494	148.5	10.4	10.25	12.16	14.5	12.2	1.4	1.3	9.6	10.8	3.6	4.3
	Largan	3008 TT	Outperform	3120.0	10,182	2435.0	28.1	134.17	155.78	18.1	15.6	1.9	1.8	11.1	11.8	2.8	3.2
	Airtac	1590 TT	Outperform	1230.0	7,018	1120.0	9.8	34.83	41.00	32.2	27.3	5.2	4.7	17.1	18.2	1.4	1.6
	Giant	9921 TT	Outperform	270.0	2,751	224.0	20.5	8.68	7.13	25.8	31.4	2.5	2.5	10.0	7.9	2.3	1.9
	DPI	4572 TT	Outperform	230.0	211	172.5	33.3	6.76	7.03	25.5	24.5	3.2	2.9	13.2	13.4	2.9	3.3

Source: KGI Research and KGI estimates

All the above named KGI analyst(s) is SFC licensed person accredited to KGI Asia Ltd to carry on the relevant regulated activities. Each of them and/or his/her associate(s) does not have any financial interest in the respectively covered stock, issuer and/or new listing applicant.

Disclaimer

All the information contained in this report is not intended for use by persons or entities located in or residing in jurisdictions which restrict the distribution of this information by KGI Asia Limited ("KGI") or an affiliate of KGI. Such information shall not constitute investment advice, or an offer to sell, or an invitation, solicitation or recommendation to subscribe for or invest in any securities or investment products or services nor a distribution of information for any such purpose in any jurisdiction. In particular, the information herein is not for distribution and does not constitute an offer to sell or the solicitation of any offer to buy any securities in the United States of America, or to or for the benefit of United States persons (being residents of the United States of America or partnerships or corporations organised under the laws of the United States of America or any state, territory or possession thereof). All the information contained in this report is for general information and reference purpose only without taking into account of any particular investor's objectives, financial situation or needs. Such information is not intended to provide professional advice and should not be relied upon in that regard.

Some of KGI equity research and earnings estimates are available electronically on www.kgi.com.hk. Please contact your KGI representative for information. The information and opinions in this report are those of KGI internal research activity. KGI does not make any representation or warranty, express or implied, as to the fairness, accuracy, completeness or correctness of the information and opinions contained in this report. The information and opinions contained in this report are subject to change without any notice. No person accepts any liability whatsoever for any loss however arising from any use of this report or its contents. This report is not to be construed as an invitation or offer to buy or sell securities and/or to participate in any investment activity. This report is being supplied solely for informational purposes and may not be redistributed, reproduced or published (in whole or in part) by any means for any purpose without the prior written consent of KGI. Members of the KGI group and their affiliates may provide services to any companies and affiliates of such companies mentioned herein. Members of the KGI group, their affiliates and their directors, officers and employees may from time to time have a position in any securities mentioned herein.